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C O N F I D E N T I A L SECTION 01 OF 02 TEL AVIV 006632

SIPDIS

E.O. 12958: DECL: 12/28/2014

TAGS: [ECON PREL EFIN KWBG IS ECONOMY AND FINANCE PEACE PROCESS ISRAELI PALESTINIAN AFFAIRS GAZA DISENGAGEMENT](#)
SUBJECT: NETANYAHU AND CODEL LIEBERMAN DISCUSS ECONOMIC REFORM, PROSPECTS FOR PEACE

Classified By: Ambassador Daniel C. Kurtzer for reasons 1.4 (b) and (d)

11. (C) Summary: CoDel Lieberman met with Minister of Finance Binyamin Netanyahu on Tuesday, December 28 to discuss elements of the Ministry's economic reform package, as well as prospects for advancing the peace process in the wake of Arafat's death and the rise of a new PA leadership. On the economy, Netanyahu said that Israel has achieved the equivalent of "ten years of growth" via privatizations, pension reform, reducing taxes, cutting government spending, and a welfare-to-work agenda that will bring 80 percent of poor families above the poverty line within one year. He noted that while he does not like the way some 150,000 illegal foreign workers have been "rounded up" and deported, their departure is crucial to lowering unemployment. On the peace process, Netanyahu said Israel is in a "moment of opportunity" for re-engaging with the Palestinians, but that what he termed U.S. hopes for teaming up with Europe to apply pressure on the PA to reform are misplaced since "Europe consistently fails to see Palestinian shortcomings." The change in PA leadership will be meaningless without societal change and Fayyad-like reforms across the board, he said, but with a real partner for peace Israel will spare no effort to reach a final settlement. Netanyahu expressed his concern over threats of violent resistance to disengagement from "tens of thousands" of settlers, saying only a national referendum could calm the waters. End summary.

Encouraging Growth by Trimming Government Fat

12. (C) CoDel Lieberman met with Minister of Finance Binyamin Netanyahu December 28 to discuss a range of economic and political issues. Netanyahu began the meeting with a discussion of the effects of his broad economic reform agenda, noting that simply by "opening up the economy" Israel has achieved the equivalent of "ten years of growth" during his tenure. "Israel has made the fastest transfer to a complete market economy the world has seen." Noting that per capita income is up and the deficit is down, Netanyahu said he expects over four percent annual economic growth within the next two to three years. A key feature of his agenda has been "slimming down" the public sector, historically 60 percent of GDP, via aggressive privatizations including El Al airlines and the banking and telecom sectors. He noted that significant corporate and VAT tax breaks as well as government payroll cuts are additional elements of MinFin's program of economic reform.

13. (C) Netanyahu said that while most countries have avoided tackling pension reform, he did so by nationalizing union pensions, raising the age of retirement across the board, and modestly cutting benefits while increasing contributions. Similarly, his welfare reform program has reduced the "fat man of welfare" from 56 percent of GDP to 51 percent. When opponents of welfare reform cite poverty statistics, he explained, they ignore the fact that within one year, MinFin's welfare-to-work program will raise approximately 80% of working poor families well above the poverty line. Netanyahu also highlighted the special police unit he had set up to uncover welfare fraud, something that "everyone does," and in major cases can waste millions of shekels of taxpayers' money.

Foreign Workers Removed to Make Room for Israeli Unemployed

14. (C) Netanyahu said that there is a relationship between the 300,000 foreign workers that until recently resided in Israel, and the same number of Israeli unemployed. "You can't find a Jewish construction worker or a Jewish house cleaner in Israel," he noted. Explaining that he did not like some of the methods the GOI used to round up and deport over 100,000 illegal workers, he said that their departure was one-half the equation to bring Israelis back to work. Palestinians should not replace the Romanian, Nigerian, Thai and Philippine laborers who have left, he said -- it must be Israelis, both Jewish and Arab, who take over vacant jobs via welfare-to-work.

Potential in New PA, But Nothing Certain Yet

15. (C) In response to a question from Senator Lieberman, Netanyahu said that he believes Israel could find itself in a moment of opportunity for engagement with the Palestinians in the wake of Arafat's death and the rise of new PA leadership. Arafat represented the "worst of Arab Islamic tendencies, a complete negation of Israel's existence," he said. Real progress, however, depends on deep-seated changes within Palestinian society, as well as reforms throughout the PA that are similar in scope to what Salaam Fayyad has done within the Ministry of Finance. In Netanyahu's view, a change in leadership without these elements in place will be nothing but "replacing a dictator with a more benign-appearing dictator."

16. (C) On change within Palestinian society, Netanyahu observed that Israel should not leave the territories without dismantling the terrorist infrastructure and eliminating elements of incitement. On PA reform, he said its success depends heavily on American pressure. He was pessimistic that Bush administration hopes of joint U.S.-EU pressure on the PA would come to fruition, due to what he called Europe's historic inability to see the extent of corruption within PA ministries. Overall, he said, if Abu Mazen and the new leadership can shape the PA into a "compliant and willing" partner for peace, Israel will go to any length to reach final status solutions. In the near-to-medium term, he said that the GOI hopes that disengagement after Gaza withdrawal can be negotiated, particularly the thorny and urgent issue of air and sea access for goods entering PA territories.

Settler Resisters Threatening Rule of Law

17. (C) Netanyahu said he fears that the tens of thousands of settlers that he said are threatening violent resistance to evacuation from the Gaza Strip and parts of the northern West Bank pose a "real danger" to the rule of law in Israel. He explained that the situation is a tragic one no matter the outcome -- if Israel does not respond to settler violence it shows it cannot govern; and if it does respond, the ensuing clashes could tear the fabric of Israeli society. He said that the only way out of this dilemma is a referendum. Sharon could win it hands down, he said, and it would force more settlers to accept disengagement as the will of the Israeli people, not just the Prime Minister.

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